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The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

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Stepping Hard On The Monetary Brakes . . .

One result of the continuing upward spiral of both credit demands and interest rates, together with the increasingly restrictive nature of monetary policy, has been the emergence of a credit squeeze similar to that experienced earlier this year. Although such credit developments normally occur near business cycle peaks, when sectors of the "real" economy have depleted their own internal cash sources and require increasing amounts of external finance, ongoing high rates of inflation continue to swell credit demands despite the weak economy, prompting the Federal Reserve to step hard on the monetary brakes.

Perhaps the most important element in the unfolding credit squeeze is the restrictive nature of monetary policy. This reflects the continuing attempts by the Federal Reserve to slow the growth of the money supply and, ultimately, subdue the rate of inflation. Interest rates have jumped sharply in recent months, unusual during a period that had generally been considered the initial phase of an economic recovery. Rates typically fall during the early stages of a recovery, as a result of existing slack in the real economy as well as the banking system, limited cyclical improvements in the inflation rate statistics as productivity rises relative to wages and an accommodative monetary policy posture. Although the appearance of a credit squeeze at the current stage of the business cycle would be unusual, it is probably not unexpected. Monetary policy stringency now seems to be the only sustained effort by the public authorities to slow the rate of inflation and brake the sharp deterioration of inflation expectations.

One indication of the tighter monetary policy stance which has emerged is the steeply inverted yield curves which now exist in almost all sectors of the financial markets. The U.S. government security yield curve, for example, is sharply inverted, with a negative 500 basis point spread now prevailing between three-month Treasury bill rates and 30-year bonds. Seldom has such a negatively sloped yield curve appeared without a subsequent recession. Put simply, borrower and investor expectations, and actions, clearly point to a secondary dip in the economy in early 1981.

Other yield spread relationships are also symptomatic of spreading illiquidity in the financial system. These include a prime rate well above mortgage and consumer lending rates, presaging further bank restrictions on loans for housing and consumer spending in the near future and commercial paper rates that are well in excess of new long-term triple-A utility yields. Similarly, short-term Treasury bill rates are far above returns available on regular passbook deposit accounts and even more attractive than returns prevailing on six-month money market certificates and 30-month small saver certificates at the nation's thrift institutions. This suggests renewed disintermediation at these institutions in the near future or, at the very least, weak deposit growth followed by further constraints on mortgage availability.

. . . Ensures That Another Credit Squeeze . . .

But steeply inverted yield spread relationships are not the only indicators of emerging crunch conditions. Short-term business loan demand has soared, despite sharp increases in the prime rate and commercial paper rates. Between October 29 and November 26, for example, commercial and industrial loans outstanding, adjusted for seasonal variation, expanded at a 24 per cent annual rate and have advanced at a more than 18 per cent annual rate during the past three months. Outstanding commercial paper for nonfinancial corporations has also begun to rise again, increasing at an almost eight per cent seasonally-adjusted annual rate during the four weeks ending November 26.

Although the sharp surge of bank loans partially reflects the more aggressive pricing posture adopted by the commercial banks in light of the competitive threat posed by the paper market, their recent rise is pressing against bank liquidity positions. This, in turn, has compelled banks to step up their purchases of funds and push short-term interest rates even higher. Plainly, soaring short-term loan demand and rising business loan rates are indicative of the later stages of economic expansion rather than the onset of a sustained economic recovery.

Because the prime rate now stands above mortgage and consumer installment loan rates, some banks have begun to ration credit to households and small

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businesses. First, even with the introduction of new variable rate mortgage instruments, the fixed-rate nature of most mortgage loans has made them increasingly unattractive for the loan portfolios of banks and thrift institutions, especially in relation to variable-rate business loans. Second, the combination of interest rate usury ceilings in some states and rising delinquency and bankruptcy rates has increased the relative attractiveness of business to consumer loans even further, limiting the volume of new credit extended to the household sector. The result: A squeeze on household spending in early 1981, but with sufficient credit for business unless even sharper restrictions are imposed by the central bank.

Together with availability, the affordability of new mortgage and consumer loans has been seriously affected by the upward reversal of interest rates. Among the first to be impacted: the credit sensitive housing and automobile industries. New home sales have declined 15 per cent since August, and domestic automobile sales remain sluggish despite the introduction of the new fuel-efficient 1981 models. The higher prices of these items, together with increased loan rates, have already impaired the ability of consumers to meet average monthly payments, further deterring new purchases and sure to exacerbate rising delinquency rates and personal bankruptcies.

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 12/3/80	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov't and Agencies Owned Outright & RPs	128.103	– 2.130	+ 2.233
Loans to Depository Inst.	2.142	– .073	+ .323
Float	5.645	+ 2.436	+ .603
Total Reserve Bank Credit	142.641	+ .518	+ 4.759
Treasury Deposits with Federal Reserve Banks	2.845	– .101	+ .250
Currency Outside Banks	120.909	– .118	+ 9.633
Member Bank Reserves:			
Required	39.910	+ .006	– 3.478
Excess (Deficiency)	.965	+ .619	+ .717
Total Reserves Held	40.875	+ .625	– 2.761
Net Borrowed Reserves	1.067	– .687	– .403
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	90.562	+ .326	+14.560

Monetary Aggregates †		% Change Since Three Months Ago*	% Change Since Year Ago
M-1A	388.7	+ 9.9‡	+ 5.8‡
M-1B	413.9	+ 12.4‡	+ 7.9‡
M-2 (October '80)	1,653.6	+ 10.9	+ 9.5
L (September '80)	2,296.0	+ 12.0	+ 8.8

† Seasonally adjusted. * Seasonally adjusted annual rate. ‡ Four-week moving average.

New York Money Market

	3 Months	6 Months	1 Year
Offering Rates 12/12/80			
‡ U.S. Treasury Bills	16.65%	15.37%	13.75%
* Federal Agencies	19.41	17.00	15.81
* Project Notes—Taxfree (46% Taxable Equivalent)	14.81	16.20	15.28
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	20.50	18.50	

‡ Finance Company Paper—Prime

5- 14 days	19.87%
15- 29 days	19.90
30- 59 days	19.87
60-179 days	17.00
180-270 days	15.00

‡* Bankers' Acceptances

Jan.	20.00%
Feb.	20.00
Mar.	19.50
Apr.	19.00
May	18.00
Jun.	17.25

‡ Industrial Paper—Prime

30- 89 days	20.50%
90-120 days	20.00

† Federal Funds Effective Rate 19.50%

‡ Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	3rd Q'80	$ 2,587	$ 2,521	$ 2,397
Gross National Product (1972 Dollars)*	3rd Q'80	$ 1,412	$ 1,409	$ 1,433
Percent Change, Annual Rate	3rd Q'80	0.9%	– 9.6%	3.1%
Change in Consumer Prices (all urban consumers)*	Oct '80	12.0%	12.0%	12.0%
Change in Producer Prices*	Nov '80	7.2%	9.6%	14.4%
Civilian Employment (Thousands of Persons) †	Nov '80	97,396	97,176	97,608
Unemployment as % of Civilian Labor Force †	Nov '80	7.5%	7.6%	5.8%
Personal Income*	Oct '80	$ 2,190	$ 2,167	$ 1,981
Leading Indicators Composite Index (1967=100) †	Oct '80	136.3	135.1	137.8
Industrial Production Index (1967=100) †	Oct '80	146.0	143.7	152.7
Net Change in Consumer Installment Credit †	Oct '80n	$ 1.46	$ 1.45	$ 2.19
U.S. Merchandise Trade Balance †	Oct '80	–$ 0.97	–$ 0.76	–$ 2.36
Plant and Equipment Expenditures*	1st Q'81n	$310.59(a)	$193.17(a)	$291.89
Private Housing Starts (Thousands of Units)*	Oct '80	1,569	1,545	1,710
New Construction Expenditures*	Oct '80	$ 225.0	$ 224.1	$ 239.9
Total Business Inventories †	Sept '80	$ 454.5	$ 452.0	$ 418.5
Total Business Sales †	Sept '80	$ 317.6	$ 308.0	$ 296.8

* Seasonally adjusted annual rate. † Seasonally adjusted. n-Newly reported figure. a-Anticipated.

. . . Will Dampen Activity Again

Finally, the climb in interest rates and the instability in the long-term bond markets have abruptly interrupted the restrengthening of household and business balance sheets. The resumption of heavy, short-term business borrowings, at higher cost, has resulted in a reversal of the process of refunding short-term debt in the long-term markets as well as reducing their debt service burdens. The restructuring of household balance sheets also remains incomplete. They continue to deteriorate as a result of the ongoing depreciation of real purchasing power due to inflation, still very high levels of existing consumer debt and the need to replenish extremely depleted savings. For despite some improvements, many key indicators of household liquidity remain relatively weak. At almost 16.5 per cent, for example, the installment debt-to-disposable income ratio is well above the comparable stage of any other economic contraction.

On balance, strains developing, and already existing, in the financial system may make certain that the real economy will once again begin to contract. While the downturn will be initially concentrated in the credit-sensitive housing and automobile sectors, it will eventually spread to other areas such as inventory investment and capital spending. ■

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Negotiable Time CD's Weekly Reporting Banks			
Nationwide (11/26/80)	107,452	+ 2,675	+13,864
New York City (11/26/80)	26,839	+ 829	+ 6,729
Commercial Paper (11/26/80)	125,930	– 125	+14,637

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (11/26/80)	171,451	+ 1,980	+18,565
New York City (11/26/80)	50,458	+ 704	+ 5,668

Total Loans Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (11/26/80)	420,190	+ 2,363	+30,184
New York City (11/26/80)	98,145	+ 366	+11,425

Financial Markets

	Friday 12/12/80	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	17.45%	+ .85	+ 4.32
180-Day Bills†	16.74	+ .74	+ 3.36
Longest Bills†	15.30	+ .20	+ 2.73
Recent Issues:			
13⅞s 11/30/82	14.62	+ .28	
12⅛s 9/30/84	13.85	+ .28	
13s 11/15/90	13.20	+ .34	
12¾s 11/15/10	12.70	+ .40	
Municipals:			
Bond Buyer–20 Bond Index* (12/11/80)	10.42%	+ .58	+ 3.16
Blue List Total ($ Million)	$ 888	+ $ 55	– $ 6
30-Day Visible Supply ($ Million)	$2,921	+ $519	+ $1,957
Total	$3,209	+ $574	+ $1,951
Corporates:			
Moody's Aa Composite (12/11/80)	14.25%	+ .62	+ 3.17
Money Mgr.–30-Day Supply ($ Million)	$3,463	– $475	+ $2,207
Stocks:			
Dow-Jones Averages:			
Industrials	917.15	– 39.08	+ 74.20
Transportation	381.24	– 17.04	+ 127.00
Utilities	111.47	– 2.77	+ 2.00
65 Stocks	357.29	– 14.49	+ 56.18
Standard and Poor's 500 Stocks	129.23	– 4.80	+ 20.31
N.Y.S.E. Composite Index	74.16	– 3.00	+ 11.81
N.Y.S.E. Avg. Daily Vol. for Week (000's)	55,501	+14,919	+ 19,173

* 46% Taxable equivalent 19.30%.

† Bond equivalent.

International Rates

	Friday 12/12/80	Week Ago
EURODOLLAR DEPOSIT RATES (bid)		
Overnight	20.87%	19.25%
1 month	22.75	19.50
3 month	21.75	19.13
6 month	19.62	17.69
1 year	17.12	16.00
EURODOLLAR BONDS Average Yield		
Medium Term (5 to 7 yrs.)	13.70%	13.50%
Long Term (7 to 15 yrs.)	13.30	13.00

FOREIGN EXCHANGE SPOT RATES

New York Opening (12/12/80)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.03083	32.43
Canada	.8312	1.2030
Denmark	.1617	6.1840
France	.2145	4.6610
Germany	.4957	2.0175
Italy	.001046	956.25
Japan	.004749	210.55
Mexico	.04308	23.21
Netherlands	.4566	2.1900
Switzerland	.5466	1.8295
U.K.	2.3085	.4332

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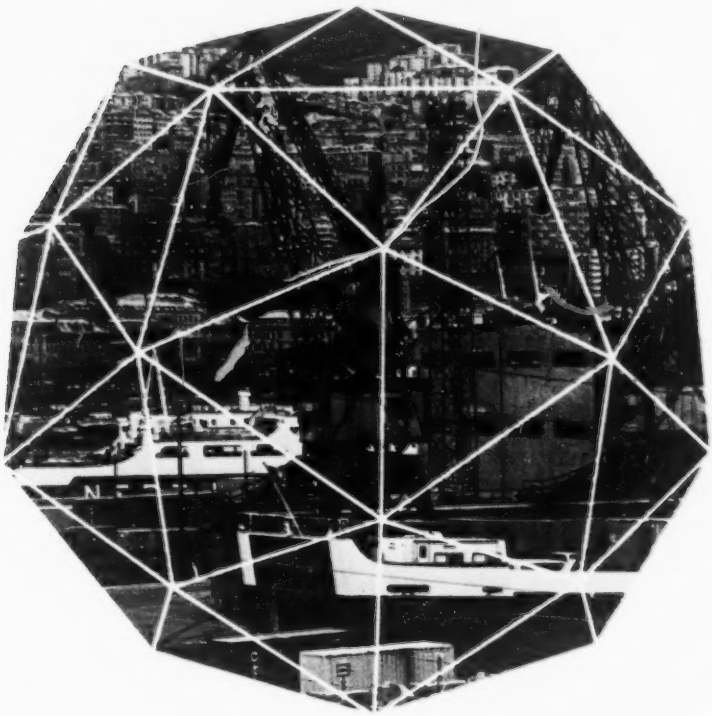

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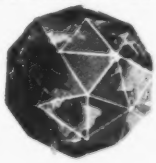

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